ACTIONS FOR IMPROVEMENT REGARDING CAPITAL ACCESS AND LENDING THROUGH SBA

August 4, 2009 8 am until 10 am

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We would like to thank Congressman Schrader for inviting us to this hearing today. It is a pleasure to be here. It is our understanding Congress is in recess. Growing up, recess was always an activity we enjoyed but it never involved work so we all appreciate you taking your recess break to listen to our thoughts. We would also like to thank Jon Pugsley for organizing the panel discussion. We feel this topic is very important, especially today, in light of events of the past year. Small businesses are the back bone of our economy. They employ the majority of our labor force. Our bank is a small business. It is the small businesses that provided entrepreneurship and creativity that has made the United States the envy and most emulated society in the history of the world.

Today, we would like to focus on how we got here and where do we go forward. We will include the lessons learned and how to improve our systems for capital access including the SBA, from a small business banking perspective. In order to implement actions for improvement, you have to understand what happened. Our country has been faced with an unprecedented series of events that has placed small businesses at risk. Access to capital and loans are critical for all businesses but especially small businesses. Pioneer Trust Bank has served the financial needs of small companies since 1924. We have grown with Salem and have branches only in Salem. This past year has been very difficult for almost everyone. Our economy has seen several bubbles, or excesses, which individually were devastating on their own right, but collectively has brought us to near financial disaster. The dotcom or NASDAQ bubble, the real estate bubble, the stock market bubble, and the oil/commodities price bubble, each have raised and then dramatically lowered net worth's of individuals and businesses. We will focus on the real estate bubble.

The real estate bubble was, in a large part, caused by leveraging in the banking and shadow banking system. The shadow banking systems are the brokerage and investment companies who have been competing with traditional banks but are not regulated, or have marginal regulation. In the 1990's, conventional real estate loan underwriting standards were reduced to include higher debt to income ratios to qualify, and lower to no down payments, so more Americans could achieve the American Dream of home ownership. Banks were encouraged by the Community Reinvestment Act (CRA) to provide creative ways for individuals to be able to get into owner occupied housing. We increased our loan to deposit ratio to satisfy CRA but this put at risk safety and soundness due to leveraging. Government Sponsored Entities (GSE) such as FHLMC/Freddie Mac and FNMA/Fannie Mae did the same. The Federal Home Loan Bank (FHLB) system provided banks with the leveraged liquidity as the rapid pace of loan growth far exceeded the banks ability to raise core deposits and capital. Brokered deposits also filled this niche for bank liquidity. The search for higher yields and greed in some cases fuelled this growth engine virtually unregulated. Investment banks packaged up and sold loans to more hungry investors who wanted these yields which were deemed "AAA" rated. Once the bubble burst, real estate prices started to tumble, people could not afford to make the payments, loans came due and could not be paid back and were not renewed, and even some loans were contracted to have higher interest rates and payment schedules later in spite of lower interest rates. This was a form of real estate "Ponzi" scheme where consumers were relying on the continued inflation of housing values to pay for their living standards and to make the payments they otherwise could not afford.

Financially, the regulators came in and told the banks to shape up. Bank capital was eroding rapidly as losses mounted and collateral margins dropped dramatically. The banking system was now deleveraging. They were forced to call in loans, writing down loans, and charging off loans. Small businesses were now feeling the pinch as the banks were trying to raise liquidity. Small businesses benefitted and thrived prior to the deleveraging as consumers spent the equity in their houses, which we called ATM machines it was happening so fast. As home values dropped, consumers could not take any more funds from their homes, spending started to dry up, and the domino effect from business to business took place where orders slowed, personnel were laid off, and unemployment became rampant to levels not seen in decades. Stock markets dropped correspondently as earnings and forecasted earnings were lowered. Retirement plans and 401-k values decreased taking the consumer demand down with it. The consumer stopped spending and realized they needed to save more. Consumption was down and savings up but that does not help small businesses today, especially since banks have not seen much of this increase in savings through core deposits. As regulators continued the pressure on the banking system to deleverage, small businesses now were in a full squeeze as they were denied the access to needed capital and liquidity to survive during these times. Even businesses that were cautious and had capital saw this erode as few were prepared for this length of a downturn. Regulators placed banks in a difficult position. We had a dual mandate; preserve and attract capital, increase our allowances for loan and lease loss reserves but, at the same time, keep lending and deleverage. This does not work. They want us and encourage us to work with our borrowers. We agree and have always implemented this philosophy. In the same light, we have to classify these loans which are work outs and we get criticized for having them on our books. We agree there needs to be transparency but there also needs to be some leniency to work through loan problems without being penalized or severely criticized.

Pioneer Trust Bank has not participated with SBA. We refer the requests to other agencies such as John Safstrom at the Mid-Willamette Valley Council of Governments here in Salem. We decided many years ago to provide sufficient capital and liquidity to meet the needs of our customers and have been managed accordingly. We have not been leveraged. The SBA has been and needs to continue to be the bridge for many banks to help them through these times. Unfortunately, the SBA has been, in our opinion, bureaucratic and therefore has no appeal to our bank. Other banks and agencies have specialized loan officers to make these loans. This should change and the SBA should be a vehicle for all banks to utilize, not specialized loan officers.

Lending is a risky business. We understand and accept this. There are no guarantees. We have gone through good times and not so good times. Banks should build up capital and allowances for loan losses during the good times. Some businesses and banks have been defined as too big to fail. This is wrong. This is against capitalism and as a result, we have failed our basic principles. There was no structure in place to prevent these potentially catastrophic banking and shadow banking failures. The shadow banking system needs to be regulated. The banking system is already burdened with regulations. The regulations and guidance were not evenly enforced or followed. Our bank is a national bank and is regulated by the Office of the Comptroller of the Currency (OCC). Our experience tells us the OCC was on top of this problem. Their field crews gave us best practices and guidance. We felt prepared and understood the risks of today. In good times, some regulators appeared to be not as concerned about safety and soundness as evidenced by the concentration of credit in some areas with respect to construction and land development loans and now commercial real estate loans. Yet in bad times they are all over the banks with Cease and Desist orders. They need to be consistent. The problems did not surface overnight. Some banks did not have diversified portfolios. Other banks took on too much risk.

Where was the oversight? Again, the policies and regulations were already in place. Now banks are faced with new and increasingly more regulations from law makers. In their attempt to make these new regulations clearer for the borrower or consumer, those individuals and businesses end up not understanding the new regulations and the cost of borrowing increases adding insult to injury. The paperwork needed for a loan is burdensome and complicated. You cannot possibly save the consumer from every trick or gimmick out there. Let the buyer beware. Government overreacts because the public overreacts. Let calmer voices and reasoning prevail. The songwriter and singer Jimmy Buffet once wrote that a tattoo is a permanent reminder of a temporary feeling. The banks get tattooed frequently. Make credit and terms less complicated and easy to understand. There are so many compliance requirements today and the consumer signs their name so many times they get finger cramps. We go over all these forms with them and they take copies back, but some still do not understand.

As previously stated, the banks are already highly regulated. The shadow banking system is not. For small business and the SBA to continue to grow and thrive we need to enforce the regulations already in place and stop burdening the system with ridiculous and wasteful new proposals which ultimately costs the consumer and small business. We all want the flow of capital and loans. We are encouraged to do this but also warned to be careful. Once again, a dual mandate. What can you do to help small business and give them access to capital? Start by making markets open again and give banks the freedom and ability to conduct business without excessive regulations, burdens, and costs. Streamline the process and have banks work with the SBA and GSE's as a partnership. Give us the tools and flexibility we need but don't give us volumes of regulations we have to follow in order to comply. The consumer is protected. They need to be educated and informed. We spend hours upon hours with them on every transaction. Each loan we do is fully customized to the consumers' and small business' needs. This is what a bank should and does do. If the SBA would use this model and be in partnership with the banks, plus being flexible instead of rigid, it will work much better.

The Government, the Federal Reserve System, and Regulators should do their part with oversight of the financial, banking, and shadow banking systems, using existing regulations and best practices. The best way to provide access to capital through the SBA, the banking system, or any other entity is to make sure free markets continue to flow, watch for bubble signs, smooth the highs and the lows of the business cycles, use the available monetary and fiscal tools available, and make sure the safeguards are in place to oversee the banks and the shadow banking system.

We want to thank you for your valuable time and consideration.

Respectfully submitted July 30, 2009 by Randy Compton and Steve Nass